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No. 84-1258 (4)

IN THE
Supreme Court of the United States
OCTOBER TERM, 1984

CHEMICAL BANK and
WASHINGTON PUBLIC POWER SUPPLY SYSTEM,
Petitioners,

v.

PUBLIC UTILITY DISTRICT NO. 1 OF BENTON COUNTY, WASHINGTON, *et al.*,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF WASHINGTON

MOTION FOR LEAVE TO FILE A BRIEF AS *AMICI CURIAE*
AND
BRIEF FOR THE AMERICAN BANKERS ASSOCIATION, THE NEW YORK CLEARING HOUSE ASSOCIATION AND THE SECURITIES INDUSTRY ASSOCIATION AS *AMICI CURIAE*

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MOTION FOR LEAVE TO FILE A BRIEF AS *AMICI CURIAE*

The American Bankers Association, The New York Clearing House Association and the Securities Industry Association respectfully move pursuant to Rules 36.1 and 42 of the Rules of this Court for leave to file the brief annexed hereto as *amici curiae* supporting the petition for a writ of certiorari. Although the petitioners and one of the respondents have consented to the filing of the brief, *amici* have been unable to obtain the consent of the remaining respondents.

The decision of the Supreme Court of the State of Washington nullifying certain of the respondents' pledges of credit to support bonds issued by petitioner Washington Public

Power Supply System raises questions of substantial importance to the Nation and its capital and credit markets. If allowed to stand, that decision will substantially and adversely affect the members of the three *amici,* who are significant principals, intermediaries, and advisors in the credit and capital markets of the United States. For that reason, and as more fully stated in the brief under the heading "Statement and Interest of *Amici Curiae,*" the members of the *amici* have a vital and continuing interest in the outcome of this action that can only be protected by review by this Court.

The three *amici* therefore pray that the Court grant this motion for leave to file their brief.

Respectfully submitted,

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BRIEF FOR THE AMERICAN BANKERS ASSOCIATION, THE NEW YORK CLEARING HOUSE ASSOCIATION AND THE SECURITIES INDUSTRY ASSOCIATION AS *AMICI CURIAE*

The American Bankers Association (the "ABA"), The New York Clearing House Association (the "Clearing House") and the Securities Industry Association (the "SIA") submit this brief as *amici curiae* in support of the petition and on an issue of vital importance to the rule of law and to the Nation's capital and credit markets: Whether the Constitution permits repudiation of pledges of credit by a State or its municipalities on which money has been borrowed and spent, leaving the creditors wholly without legal or equitable recourse.

Statement and Interest of *Amici Curiae*

The ABA is the largest national association of commercial banks, numbering among its members 13,000 banks (about 93% of domestic commercial banks) located in fifty States and the District of Columbia. The Clearing House is an association of twelve leading commercial banks in the City of New York. The SIA is an association of over 500 brokers and dealers responsible for over 90 percent of the country's investment banking and securities brokerage business. Each of the three *amici* regularly participates as a party or *amicus curiae* in cases raising important questions of law affecting its members' businesses.

The members of the three *amici* act as principals, intermediaries, and advisors in the credit and capital markets of the United States. The members of the ABA and the Clearing House extend tens of billions of dollars of loans to States and their instrumentalities and municipalities and hold hundreds of billions of dollars of the bonds and notes of such issuers in their own investment portfolios and trust accounts.[1] The members of the SIA bring to market as underwriters all types of debt instruments by which such issuers finance their cash flow and capital requirements and make markets as dealers in such securities after their issue. The members of all three *amici* act as advisors to millions of individual Americans, many of modest means, who have devoted a good portion of their lives' savings to such investments, depending on them for retirement income and as secure capital for unforeseen needs and for estate purposes.

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[1] Commercial banks hold about one-third of the outstanding state and municipal bonds. LEHMAN BROTHERS, PUBLIC POWER FINANCE: THE YEAR IN REVIEW AND CHALLENGES FOR THE FUTURE 7 (1984) (hereinafter "LEHMAN BROTHERS"). Commercial banks also underwrite general obligation bonds of public issuuers for distribution to the public.

As the Court knows, the banking and securities *amici* have appeared here in opposition to one another in cases where the Court has been called upon to determine the line of demarcation between their two businesses set by Congress. *See, e.g., Securities Industry Ass'n* v. *Board of Governors,* 104 S. Ct. 3003 (1984); *Securities Industry Ass'n* v. *Board of Governors,* 104 S. Ct. 2979 (1984); *Board of Governors* v. *Investment Company Institute,* 450 U.S. 46 (1981). On this occasion they are united in urging the Court to require the State of Washington to accept and adhere to the Court's unbroken and unequivocal line of decisions requiring the States and their subordinate entities to honor their commercial obligations.

Summary of Argument

The decision below is directly contrary to this Court's consistent teaching that States and municipalities must honor their commercial undertakings. *E.g., United States Trust Co.* v. *New Jersey,* 431 U.S. 1, 24-25 (1977); *Worthen Co.* v. *Kavanaugh,* 295 U.S. 56, 60 (1935); *Hitchcock* v. *Galveston,* 96 U.S. 341, 350 (1877). This Court is the only available forum for the enforcement of that requirement in this case, a requirement which is both the essential underpinning of public credit and an important element of the rule of law established by the Constitution. To allow the decision below—which upholds the largest repudiation of public obligations in the Nation's history—to stand would be to draw into question this Court's readiness to enforce other state and municipal obligations and thereby to encourage repudiation of such obligations and undermine confidence in the country's capital and credit markets.

ARGUMENT

The compelling reasons for review of this case are fully stated in the Petition and need not be repeated at length here. We will discuss only the importance and error of the principal substantive ruling made below, which is raised by Question 1 of the Questions Presented (Petition at i). Before doing so, however, we wish to note that even if the Constitution were to admit of the possibility of the total avoidance of public obligations on the ground they are *ultra vires*—which it does not—the decisional process below cannot be thought to have met the due process requirements of the Fourteenth Amendment. *See* Petition at 23-27; *Goldberg* v. *Kelly*, 397 U.S. 254, 269, 271 (1970); *Thompson* v. *Louisville*, 362 U.S. 199, 204, 206 (1960); *Ohio Bell Tel. Co.* v. *Public Utilities Comm'n*, 301 U.S. 292, 300 (1937). Consequently, certiorari is independently warranted by Question 2 of the Questions Presented (Petition at i-ii).

I.

This Court Has Consistently Recognized Enforcement of State Contract Obligations To Be an Important Responsibility.

A.

This case involves the largest repudiation in United States history of a public pledge of credit. The participants in the final two projects of petitioner Washington Public Power Supply System (the "Supply System") have disavowed their repayment obligations on borrowings totalling approximately $2.25 billion in principal and additional billions in interest (B3).[2] At the time the issues went into default,

[2] "A" and "B" citations are to the Appendix to the Petition for Certiorari.

the Supply System was one of the Nation's largest issuers of municipal bonds. *WPPSS Default on $2.25 Billion in Bonds Is Record for Municipal Debt; Suits Seen,* Wall Street Journal, July 26, 1983, at 3, col. 2. Its $2.25 billion default exceeds by 50 percent the total value of all municipal defaults in this country during the Great Depression. *Possible Effects of a WPPSS Bond Failure Are Visible in Past U.S. Municipal Defaults,* Wall Street Journal, July 13, 1983, at 33, col. 4.

At present, it is estimated that there are more than 1.5 million issues of public notes and bonds outstanding in this country, issued by more than 50,000 separate entities. M. HERNANDEZ & D. BRADBURY, AN ANALYSIS OF THE TAX EXEMPTION FOR STATE AND LOCAL DEBT 23 (Kidder, Peabody & Co. Sept. 1984) (hereinafter "HERNANDEZ & BRADBURY"). During 1984 alone, more than $93.3 billion of municipal bonds were sold in 5,332 separate issues. Credit Markets, Jan. 17, 1985 at 30. Of that vast sum, approximately $10.8 billion, or roughly 11.7 percent of the total dollar amount, were public-power offerings. Credit Markets, Jan. 7, 1985, at 29, col. 4.

The traditional buyers of municipal bonds are risk-averse individuals and institutions—trust departments, retirees, and persons wholly dependent upon investment income. HERNANDEZ & BRADBURY at 21. In the fourth quarter of 1983, individual investors directly owned 36.6 percent of all outstanding tax-exempt bonds and, through their investments in mutual funds, indirectly held another 24 percent of the total. *Id.* at 12. At the time of the Supply System's default, it was estimated that 60 percent to 70 percent of its bondholders were individuals. *See Huge Bond Default Touches Everybody,* Kansas City Star, July 27, 1983, at 9A, col. 3.

The devastating effect of the default on these individuals is not hard to envision. Many invested a large part of their lives' savings in bonds that were deemed investment grade securities on the basis of the participants' pledges which the Washington Supreme Court has now rendered null and void. In the wake of that court's first decision, the press was replete with stories describing the plights of many who were caused great financial hardship by the Supply System's default. *See, e.g., Default Angers, Horrifies People Who Bought the WPPSS Bonds,* Wall Street Journal, July 27, 1983, at 25, col. 4 (retired persons forced to return to work and parents no longer able to send children to college).

Perhaps less obvious, but also important, are the effects of the default on issuers in the municipal bond market. Some municipal issuers have been forced to pay an interest premium—commonly known as a "WPPSS penalty"—in order to market their offerings. *See, e.g.,* LEHMAN BROTHERS at 18. While this increment has subsided somewhat, there is no doubt that it is now more difficult to market municipal bond offerings than in the past. *See id.* at 18-19. Moreover, in order to achieve the degree of safety required by the risk-averse investors who purchase municipal bonds, many more new offerings must be insured, further increasing the cost of credit and squeezing weaker municipalities out of the market. *The Fallout From 'Whoops'*, Business Week, July 11, 1983, at 80, 87.

B.

Chief among the evils that impelled the several States to abandon the Confederation in favor of the Union was "an ignoble array of [state] legislative schemes for the defeat of creditors and the invasion of contractual obligations" to the extent that "the confidence essential to prosperous trade had been undermined and the utter destruction of credit was

threatened." *Home Building & Loan Ass'n* v. *Blaisdell*, 290 U.S. 398, 427 (1934); 1 G. BANCROFT, HISTORY OF THE FORMATION OF THE CONSTITUTION 229 (1882).

This Court has consistently intervened to enforce the basic constitutional requirement that States and their corporate arms abide by their contractual undertakings:

> "When a State itself enters into a contract, it cannot simply walk away from its financial obligations. In almost every case, the Court has held a governmental unit to its contractual obligations when it enters financial or other markets."

Energy Reserves Group, Inc. v. *Kansas Power and Light Co.*, 459 U.S. 400, 412 n.14 (1983). The only exception in this century where the Court has sustained the alteration of a municipal bond contract occurred in the context of a municipal bankruptcy. *United States Trust Co.*, 431 U.S. at 27; *see Faitoute Iron & Steel Co.* v. *Asbury Park*, 316 U.S. 502 (1942). And, while the Court has held the Contract Clause itself applicable only to state legislative acts, *Tidal Oil Co.* v. *Flanagan*, 263 U.S. 444, 451 (1924), the Court has also held that contract rights are property protected by the due process clause of the Fourteenth Amendment, *Ruckelshaus* v. *Monsanto Co.*, 104 S. Ct. 2862, 2873 (1984); *Pennsylvania Coal Co.* v. *Mahon*, 260 U.S. 393 (1922), and that the dictates of the latter apply to state courts as to other branches of state governments, *Webb's Fabulous Pharmacies, Inc.* v. *Beckwith*, 449 U.S. 155, 160 (1980); *Chicago, Burlington & Quincy R. Co.* v. *Chicago*, 166 U.S. 226, 241 (1897).

Moreover, in order to ensure that property rights are not defeated by arbitrary state court decisions, this Court has always recognized that it falls within its

> "province to inquire not only whether the right was denied in express terms, but also whether it was denied in substance and effect, as by putting forward non-federal grounds of decision that were without any fair or substantial support."

Ward v. *Love County,* 253 U.S. 17, 22 (1920); *accord Norris* v. *Alabama,* 294 U.S. 587, 589-90 (1935). This power of review extends to state court decisions denying federal constitutional rights on the basis of a sudden or unforseeable change in state law, such as the legal "shell game" conducted here. *Hughes* v. *Washington,* 389 U.S. 290, 296-97 (1967) (Stewart, J., concurring).[3]

In reliance on the constitutionally binding character of promises by States and municipalities to pay their debts in accordance with their terms, Americans have purchased hundreds of billions of dollars of public bonds. The confident expectation of repayment upon which public finance totally depends has been created and maintained by the decisions of this Court, and it is to this Court alone that those who have relied on its teachings can look for redress when their rights are denied by a State or its instrumentalities.

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[3] The Washington Supreme Court's ruling that the participants might repudiate their agreements as *ultra vires* without incurring the equitable obligation to repay the money already advanced by the bondholders, with compensation for its use, was certainly sudden and unforseeable, as it is contrary to elementary principles of justice recognized and established in the decisional law both of that court, *Noel* v. *Cole,* 98 Wash. 2d 375, 655 P.2d 245, 249 (1982); *Edwards* v. *Renton,* 67 Wash. 2d 598, 409 P.2d 153, 157-58 (1965), and this Court, *see Chapman* v. *Douglas,* 107 U.S. 348, 355-56 (1882).

II.

The *Ultra Vires* Doctrine Articulated Below Cannot Stand Against the Constitution, and the Decision of the Washington Supreme Court Should Be Reversed Summarily.

The Supply System was created by the State of Washington through its legislature, WASH. REV. CODE ANN. § 43.52 (1983), to act as a "joint operating agency" assisting its members and participants in meeting their needs as suppliers of electricity to their respective service areas. The participants in the two Supply System projects here at issue included nine Washington cities and nineteen Washington public utility districts (the "Municipalities"). All the Municipalites were empowered by statute to contract to construct generating facilities, to contract to purchase electricity for resale, and to contract to participate in the projects of joint operating agencies, such as the Supply System, created for the purpose of providing electricity.[4]

In the exercise of the foregoing powers, the Municipalities entered into contracts with the Supply System for the financing and construction of two nuclear generating facilities and the purchase of electricity therefrom, which contracts contained "dry hole" provisions obligating the Municipalities severally to make payments to the Supply System in amounts sufficient to service their proportionate share of the debt incurred in the construction of the two facilities whether or not a single kilowatt hour of electricity was ever generated by either facility (B5-6). The Municipalities represented that they had the authority to make those com-

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[4] WASH. REV. CODE ANN. §§ 35.22.280, 35.23.440, 35.24.290, 35.27.370, 35.92.050, 35A.80.010, 54.16.040 (1965, 1983 and Supp. 1985).

mitments, their counsel concurred, and no official of the State of Washington or of the Municipalities suggested otherwise. It was on the strength of these commitments, which were and are common contractual provisions in projects of this sort, that the Supply System sold $2.25 billion of revenue bonds for the projects to the public in 14 issues over four years.

The Washington Supreme Court has now purported to abrogate these pledges of credit in their entirety on the ground they were *ultra vires* (A21, B25-26). The Washington court had to concede that the Municipalities had the power to build generating facilities (B12), the power to buy electricity (A17, B10) and the power to participate in Supply System projects (A17, B11), and seemed to suggest they had the power to enter into any kind of contract with respect to generating facilities each might separately construct (A18, B12). The only power the Washington court apparently found them to lack was the power to enter into dry hole contracts with respect to facilities they were constructing jointly through the Supply System (A18). This, the Washington court said, was because they did not "control" the Supply System (A19)—a criterion found nowhere but in the Washington court's opinion. In fact, since 20 of the 28 Municipalities had 87 percent of the voting power on the Supply System's Board of Directors, which managed its affairs (A49), and all served on the Participants Committee, which approved all contracts of over $2 million (A7-8), this criterion was met, and the Washington court's holding otherwise is so contrary to proven and indisputable reality as to violate due process. *Thompson* v. *Louisville*, 362 U.S. 199 (1960).

Entirely apart from this Alice-in-Wonderland fact finding, however, the Washington court's invocation of "substantive *ultra vires*" as a means of abrogating the Municipalities'

obligations cannot stand in the face of this Court's decisions. Over a century ago, the Court held in words plain to legislators, judges, lawyers and investors:

> "The truth is, States and cities, when they borrow money and contract to repay it with interest, are not acting as sovereignties. They come down to the level of ordinary individuals. Their contracts have the same meaning as that of similar contracts between private persons. . . . A promise to pay, with a reserved right to deny or change the effect of the promise, is an absurdity."

Murray v. *Charleston*, 96 U.S. 432, 445 (1877); *accord United States Trust Co.* v. *New Jersey*, 431 U.S. 1, 25 n.23 (1977). This doctrine has become so fundamental to the rule of law that Congress has extended it to foreign sovereigns which enter our commercial markets. *See* Section 4(a) of the Foreign Sovereign Immunities Act of 1976, 28 U.S.C. § 1606 (1982) (a "foreign state shall be liable in the same manner and to the same extent as a private individual under like circumstances.").

When a State seeks to defeat the ordinary legal rights and justified expectations of those lending money to it or its instrumentalities, whether by act of its legislative branch or by act of its judicial branch, it contravenes the Constitution: If the action is legislative it violates the Contract Clause; if judicial it violates the Fourteenth Amendment's due process clause.

This Court long ago explicitly rejected a contention of "procedural *ultra vires*" (*i.e.*, failure to comply with internal procedures) as a defense to nonpayment by public obligors, holding that those purchasing negotiable debt instruments of such obligors are entitled to rely on official certificates of regularity. *Gunnison City Commissioners* v.

Rollins, 173 U.S. 255 (1899); *Coloma* v. *Eaves,* 92 U.S. 484 (1875). The doctrine of "substantive *ultra vires*" (*i.e.*, lack of capacity) has, of course, never been available as a defense to "ordinary individuals" (save, perhaps, infants and adjudicated incompetents) and is not so available in Washington or any other State to private corporations. WASH. REV. CODE ANN. § 23A.08.040 (1976).[5] The application of the defense by the Washington court to defeat the bondholders' rights under the circumstances presented here defies this Court's controlling decisions, and it should be reversed summarily pursuant to Rule 23.1.[6]

The Municipalities entered into contracts promising to provide the revenues necessary to service their pro-rata share of the debt incurred on their behalf; those contracts would be binding if entered into by private persons or corporations, and they are, therefore, binding on the Municipalities under the Fourteenth Amendment. The commercial bargain made by the Municipalities placed the risk of failure of the two projects involved on them, not on the bondholders, and that bargain may not be reversed because the prospect of raising utility rates to meet the Municipalities' commercial obligations is unpalatable.

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[5] The defense of *ultra vires* has been made unavailable to business corporations in 48 states and the District of Columbia by statute and in Massachusetts by judicial decision. Hawaii has no statute or reported decision mentioning the defense. Citations are set forth in the Addendum to this brief. The doctrine has been preserved only to enable shareholders to challenge corporate action in equity while a contract is executory and to sue directors who exceed their authority. *See, e.g.,* WASH. REV. CODE ANN. § 23.A.08.040 (1976).

[6] Reversal of the Washington court's holding on *ultra vires* leads to reversal of its entire decision, as the relief of the Municipalities from their obligations was the sole basis of the relief of the other participants, who are also respondents here (A25-26).

Conclusion

Certiorari should be granted and the decision below reversed summarily pursuant to Rule 23.1, on the authority of *Murray* v. *Charleston*, 96 U.S. 432 (1877), *United States Trust Co.* v. *New Jersey*, 431 U.S. 1 (1977), and *Webb's Fabulous Pharmacies, Inc.* v. *Beckwith*, 449 U.S. 155 (1980). Alternatively, certiorari should be granted and the case set down for briefing and argument on the merits of both Questions Presented.

Respectfully submitted,

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ADDENDUM

Statutes and Decision Denying the *Ultra Vires* Defense to Private Business Corporations

ALA. CODE § 10-2A-24 (1977)
ALASKA STAT. § 10.05.018 (1962)
ARIZ. REV. STAT. ANN. § 10-007 (1977)
ARK. STAT. ANN. § 64-106 (1980)
CAL. CORP. CODE § 208 (West 1977)
COLO. REV. STAT. § 7-3-105 (1974)
CONN. GEN. STAT. ANN. § 33-292 (1960)
DEL. CODE ANN. tit. 8, § 124 (1975)
D.C. CODE ANN. § 29-307 (1981)
FLA. STAT. ANN. § 607.021 (West 1977)
GA. CODE ANN. § 14-2-22 (1982)
IDAHO CODE § 30-1-7 (1948)
ILL. REV. STAT. Ch. 32, § 157.8 (1954)
IND. CODE ANN. § 23-1-10-4 (Burns 1972)
IOWA CODE § 496A.6 (1962)
KAN. STAT. ANN. § 17-1604 (1981)
KY. REV. STAT. § 271A.035 (1981)
LA. REV. STAT. ANN. § 12:42 (West 1969)
ME. REV. STAT. ANN. tit. 13-A, § 203 (1981)
MD. CORPS. & ASS'NS CODE ANN. § 1-403 (1975)
MICH. COMP. LAWS § 450.1301 (1973)
MINN. STAT. § 302A.165 (1984)
MISS. CODE ANN. § 79-3-11 (1973)
MO. REV. STAT. § 351.395 (1966)
MONT. CODE ANN. § 35-1-110 (1982)
NEB. REV. STAT. § 21-2006 (1983)
NEV. REV. STAT. § 78.135 (1979)
N.H. REV. STAT. ANN. § 293-A:7 (1983)
N.J. STAT. ANN. § 14A:3-2 (West 1969)
N.M. STAT. ANN. § 53-11-6 (1978)

Addendum

N.Y. BUS. CORP. LAW § 203 (McKinney 1962)
N.C. GEN. STAT. § 55-18 (1982)
N.D. CENT. CODE § 10-19-06 (1976)
OHIO REV. CODE ANN. § 1701.13(H) (Baldwin 1984)
OKLA. STAT. ANN. § 1.28 (West 1953)
OR. REV. STAT. § 57.040 (1981)
PA. STAT. ANN. tit. 15, § 1303 (Purdon 1967)
R.I. GEN. LAWS § 7-1.1-6 (1970)
S.C. CODE ANN. § 33-3-30 (Law Co-op 1977)
S.D. COMP. LAWS ANN. § 472-60 (1983)
TENN. CODE ANN. § 48-405 (1984)
TEX. BUS. CORP. ACT ANN. art. 204 (Vernon 1980)
UTAH CODE ANN. § 16-10-6 (1973)
VT. STAT. ANN. § 1854 (1973)
VA. CODE § 13.1-5 (1978)
WASH. REV. CODE ANN. § 23A.08.040 (1976)
W. VA. CODE § 31-1-10 (1982)
WIS. STAT. ANN. § 180.06 (West 1957)
WYO. STAT. § 17-1-106 (1977)

Valley Stream Teachers Federal Credit Union v. *Commissioner of Banks,* 376 Mass. 845 (1978)